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MONTANA LOTTERY

FINANCIAL STATEMENTS
(UNAUDITED)

PERIODS ENDED JUNE 30, 1988

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(Unaudited)
PERIODS ENDED JUNE 30, 1988

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APPOINTIVE OFFICIALS

Diana S. Dowling, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

		TERM EXPIRES
Spencer Hegstad, Chairman	Dillon	January 1, 1990
Pat DeVries	Polson	January 1, 1991
Glenn Osborne	Great Falls	January 1, 1989
Jim Moore	Bozeman	January 1, 1990
Keith Colbo	Helena	January 1, 1989

LOTTERY LIAISON COMMITTEE

Senator Larry Tveit	Fairview
Senator Larry Stimatz	Butte
Representative Budd Gould	Missoula
Representative John Vincent	Bozeman

REPORT DISTRIBUTION

According to Section 23-5-1007(7), MCA, copies of this report must be distributed to the following individuals.

Ted Schwinden, Governor

Ellen Feaver, Director, Department of Administration

Scott Seacat, Legislative Auditor

Bill Norman, President of the Senate

Robert L. Marks, Speaker of the House

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House requested this report be distributed to the Revenue Oversight Committee. Members of the Revenue Oversight Committee include:

Senators	Representatives
Robert Brown	Dan Harrington
Bruce Crippen	Gerry Devlin
Dorothy Eck	John Harp
Thomas Hager	Nancy Keenan
Joe Mazurek	Jack Ramirez
Bill Norman	Mel Williams

In addition, the Speaker of the House requested this report be distributed to the House Business and Labor Committee. The House Business and Labor Committee members include:

Representatives

Fred Thomas	Bob Bachini
Ray Brandewie	Jan Brown
Ben Cohen	Jerry Driscoll
William Glaser	Beverly Donaldson
Stella Jean Hansen	Tom L. Jones
Lloyd "Mac" McCormick	Thomas Nelson
Jerry Nisbet	Bob Pavlovich
Bruce Simon	Clyde Smith
Charles Swysgood	Norm Wallin

Lottery
Montana

Ted Schwinden
Governor

Diana S. Dowling
Director

Gerald J. LaChere
Operations
Nancy L. Goodspeed
Marketing
L. John Onstad
Security

2525 N. Montana
Helena, MT 59601-0542
(406) 444-LUCK

September 30, 1988

To the Montana Lottery Commission:

What a way to end the year!

For the quarter ended June 30, 1988, we transferred over $1.2 million to the State Superintendent of Public Instruction. With this fourth quarter transfer, we exceeded our first year projection by transferring over $8 million to the state. These monies, distributed to eligible counties as equalization aid for retirement funds, provide tax relief for school districts within the state.

During the fourth quarter, we celebrated our birthday by recording ticket sales of over $3.6 million! Lottery retailers received over $200,000, while winners were paid over $1.2 million in prizes.

Because the Big Spin Jackpot was not hit during the fourth quarter, the Jackpot grew to nearly $1.5 million by June 30!

In an attempt to bring the Lottery to the people of Montana, we began our "Big Spin on-the-road" show in May. We traveled throughout the state to fairs, rodeos, art festivals, and celebrations. The public response was overwhelmingly positive!

Montana Lottery Commission Members

Spencer Hegstad, Chairman
Dillon

Keith Colbo
Helena

Pat DeVries
Polson

Jim Moore
Bozeman

Glenn Osborne
Great Falls

When not "on-the-road," we responded to thousands of letters and telephone calls received from the public and listened to our employees and retailers to plan future game strategies.

By continuing to reach out and listen to Montanans, we are building a foundation for even better results in Montana's lottery for the years ahead.

Sincerely,

Diana

Diana S. Dowling
Director

DSD/sc

MONTANA LOTTERY
BALANCE SHEET
JUNE 30, 1988

	(Unaudited)
ASSETS	
Cash and Cash Equivalents	$ 3,788,451
Receivables (Net)	206,195
Inventories	192,850
Equipment	730,671
Other Fixed Assets	4,093
Accumulated Depreciation	(126,712)
Intangible Assets	672,320
Other Assets	27,148
TOTAL ASSETS	$ 5,495,016
LIABILITIES AND FUND EQUITY	
Liabilities:	
Accounts Payable and Accruals	$ 50,653
Lottery Prizes Payable	3,505,682
Due to Other Funds	1,321,413
Installment Purchase Payable	543,318
Compensated Absences Payable	74,705
Total Liabilities	5,495,771
FUND EQUITY:	
Retained Earnings Unreserved	(755)
Total Fund Equity	(755)
TOTAL LIABILITIES AND FUND EQUITY	$ 5,495,016

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PERIODS ENDED JUNE 30, 1988

	Quarter ended June 30, 1988 (Unaudited)	Twelve months ended June 30, 1988 (Unaudited)
OPERATING REVENUES:		
Charges for Service		
Net lottery ticket revenue	$3,655,854	$21,056,564
License and permits	800	5,900
Total Operating Revenues	3,656,654	21,062,464
Prizes and Commissions		
Prize expense	(1,619,690)	(9,477,279)
Retailer commission	(204,212)	(1,169,378)
Net Operating Revenue	$1,832,752	$10,415,807
OPERATING EXPENSES:		
Amortization	$ 42,020	$ 168,080
Personal Services	235,779	977,415
Contractual Services	(29,473)	139,934
Cost of tickets sold	261,288	854,056
Audit Fees	32,341	46,652
Supplies and Materials	12,251	55,119
Depreciation	24,909	107,912
Utilities and Rent	22,950	101,598
Communications	(15,306)	88,863
Advertising	35,401	573,503
Travel	9,634	55,175
Repairs and Maintenance	13,578	72,199
Management Service Fee	23,222	74,800
Other	1,959	10,833
Total Operating Expense	$ 670,553	$ 3,326,139
Operating Income	$1,162,199	$ 7,089,668
NONOPERATING REVENUES (EXPENSES)		
Interest expense	(377)	(18,022)
Total Nonoperating Revenues (Expenses)	(377)	(18,022)
Income before Operating Transfers	1,161,822	7,071,646
Operating Transfers In (Out)	(1,232,477)	(8,375,894)
NET INCOME (LOSS)	$ (70,655)	$(1,304,248)
Retained Earnings, Beginning of Period	$ 0	1,235,684
Prior Period Adjustments	69,900	67,809
Retained Earnings, Beginning of Period as Restated	69,900	1,303,493
RETAINED EARNINGS, END OF PERIOD	$ (755)	$ (755)

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
June 30, 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Montana Lottery, established under the provisions of Section 23-5-1001, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

These financial statements reflect activity for the Montana Lottery for the quarter ended June 30, 1988 and the twelve months ended June 30, 1988.

The Montana Lottery's financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting. A summary of the more significant accounting policies follows:

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the governmental Proprietary Fund Type. Enterprise Funds account for operations a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or (b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Revenue Recognition. Lottery ticket sales are recorded as revenue based on ticket deliveries to the retailers. Due to a limited historical perspective as of June 30, 1988, no reserve for estimated ticket returns has been established.

Free Tickets. The Montana Lottery's instant games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free tickets distributed approximated $402,000 and $2,302,500 for the quarter ended June 30, 1988 and for the twelve months ended June 30, 1988, respectively.

Instabucks. Instabucks are a Lottery coupon good, upon redemption, for a lottery ticket. Instabucks, used to stimulate lottery ticket sales, are usually given away for promotions, retailer clerk incentive programs, and advertising trade-outs. The lottery tickets distributed resulting from Instabuck redemptions are reflected as a reduction in revenue. The related prize expense and ticket cost are reclassified as an advertising

expense. For the quarter ended June 30, 1988, Instabuck redemptions resulted in a revenue reduction of $9,312 and a prize expense reclassification of $4,180.

Coupons. Occasionally, the Lottery promotes ticket sales by distributing coupons as matches for instant prizes. Cash prizes related to the coupons are included in the prize structure. Free ticket prizes awarded due to a coupon match are reflected as a reduction of revenue. For the quarter ended June 30, 1988, free ticket prizes awarded with a coupon match resulted in a revenue reduction of $17,296.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game. No prize expense is recorded for free tickets distributed.

Commissions. Retailers receive a five percent commission on tickets or chances sold. Commission expense is recorded based on the face value of tickets delivered to the retailers.

Amortization. The Instant Lottery System (ILS) software, classified as an intangible asset, is being amortized over a period of five years using the straight line method.

Receivables. Receivables represent amounts owing the Lottery for purchased tickets. An allowance for doubtful accounts has not been established because uncollectible accounts over 90 days old amounted to $1,675 at the end of the financial reporting periods. These uncollectible account balances represent less than 1% of the outstanding accounts receivables as of June 30, 1988.

Equipment and Other Fixed Assets. Equipment and other fixed assets are recorded at cost. Depreciation is calculated using the straight-line method over estimated lives of four to ten years.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes lottery tickets valued at $114,720 stored in the warehouse and with the marketing representatives. These ticket inventories are recorded at cost and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold when sold. After game end and awaiting disposal, unsold tickets are charged to cost of tickets sold.

Supplies inventories include paper supplies and point-of-sale materials having a value of $5,000 or more. At year end, supplies inventories totaled $78,130.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated to not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year.

Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's payable for compensated balances is detailed below.

Balance June 30, 1987	Net Leave Earned/Used	Balance June 30, 1988
$31,316	$43,389	$74,705

2. INTEREST INCOME

The Montana Lottery's cash is invested daily with other state surplus Treasury cash. The Lottery, by law, is not allowed to invest its excess cash. Using a conservative interest rate of 6.3%, Lottery monies earned approximately $432,189 for the General Fund since July 1, 1987. These interest earnings are not reflected on the Lottery's financial records.

3. PRIOR PERIOD ADJUSTMENTS

The prior period adjustments of $69,900 and $67,809 for the quarter ended June 30, 1988, and the year ended June 30, 1988, respectively reflect expense activity from the previous year recorded in the current period. Of these adjustments, $69,700 relates to a ticket rebate. The remaining adjustments reflect travel and other miscellaneous expenses.

4. GAMES

Currently, the Montana Lottery games are instant ticket games. These games provide players the opportunity to win instantly by scratching a ticket's latex covering to reveal a prize. Players also have another chance to win by submitting five non-winning tickets for the Big Spin drawing.

5. PAID PRIZES

Section 23-5-1027 MCA states "as near as possible to 45% of the money paid for tickets or chances must be paid as prize money". For the quarter ended June 30, 1988, the prize expense of $1,619,690 reflects 44.30% of net ticket revenues totaling $3,655,854. From April 1, 1988 through June 30, 1988 prizes paid are detailed as follows:

High-tier	$ 369,784
Low-tier	761,806
Big Spin	125,000
	$1,256,590

High-tier prizes reflect prizes greater than $25 paid through Lottery headquarters. Low-tier prizes of $25 or less are paid by the retailer or Lottery headquarters. Free ticket prizes totaled approximately $402,000.

6. CONTRACTUAL SERVICES AND COMMUNICATIONS.

The contractual services and communications expense of $(29,473) and $(15,306) for the quarter ended June 30, 1988 reflect the reclassification of these expenses as advertising expense.

7. TRANSFER TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION.

Section 23-5-1027, MCA states "that part of all gross revenue not used for payment of prizes, commissions, and operating expenses is net revenue and must be paid quarterly from the enterprise fund to the State Superintendent of Public Instruction for distribution as equalization aid to retirement funds..." For the quarter ended June 30, 1988, the net revenue amounts to $1,232,477. This amount was transferred to the State Superintendent of Public Instruction on July 21, 1988.

The $8,375,894 cumulative transfer figure includes the net income for the twelve months ended June 30, 1988, and the period ended June 30, 1987. The Lottery was exempted from making a transfer for the quarter ended June 30, 1987 until the general fund start-up loan had been repaid. This loan was repaid on August 19, 1987.

8. DUE TO OTHER FUNDS.

The account "Due to Other Funds" totalling $1,321,413 reflects the $1,232,477 payable to the State Superintendent of Public Instruction and $88,936 due to other state agencies for goods and services provided through fiscal year end. The $1,232,477 transfer for the quarter ended June 30, 1988 was paid to the State Superintendent of Public Instruction on July 21, 1988.

9. FUND BALANCE.

According to the law, the Lottery's net revenue must be transferred quarterly to the State Superintendent of Public Instruction. This transfer should result in a zero fund balance. However, due to the recording of a fiscal year 1987-1988 expenditure after calculation of the transfer, the fund balance is ($755) rather than zero.

10. GAMING SUPPLIER CONTRACTS

Tickets. On March 9, 1987, the Montana Lottery signed a one year contract with Scientific Games, Inc. to purchase lottery tickets. Under that contract, each instant ticket game consisted of 4,800,000 tickets or "other quantity as agreed by the parties."

This contract was extended until March 9, 1989 by letter dated February 23, 1988 and amended on May 5, 1988. The contract amendments address certain ticket specifications, price, and

quantity. The amended minimum order quantity is 4,080,000 tickets.

The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure. The contract requires payment within 30 days of ticket receipt.

Scientific Games, Inc., as the vendor, delivered a $776,104 performance bond covering the contract term. The Company also provided an errors and omissions policy covering an ultimate net loss of $5,000,000.

This contract may be terminated when termination is in the best interest of the Lottery with proper notification to Scientific Games, Inc.

Computer Hardware and Software. The Lottery contracted with Scientific Games, Inc. on February 25, 1987, to purchase a used Stratus computer. The computer hardware and software cost $381,243. This contract also covered the acquisition of an Uninterruptable Power Supply (UPS) system for $40,551. The UPS system protects the computer against electrical power surges and failures.

The Lottery signed a separate agreement with Stratus Computer, Inc. on June 2, 1987, for maintenance of the Stratus computer hardware and software. Monthly maintenance totals $4,433.

On July 28, 1987, the Lottery signed a second agreement with Stratus Computer, Inc. regarding the Stratus software license. Under this contract, Stratus Computer, Inc. grants the Lottery a "nonexclusive, nontransferable license" to use the software of the Stratus computer. The proprietary rights and title of the software remain with Stratus Computer, Inc.

Training. The Montana Lottery contracted with Scientific Games, Inc. on January 15, 1987, to provide training and start-up assistance. This contract for $250,000 required quarterly payments of $62,500 due July 24, 1987, October 24, 1987, January 24, 1988 and April 24, 1988.

Lottery Software. On February 25, 1987, the Lottery agreed to purchase the Instant Lottery System (ILS) software package for $840,400. This agreement provides the Lottery a "perpetual, non-exclusive, nontransferable license to use the software solely for the Lottery's own use". The contract allows the Lottery to make 36 monthly payments of $23,344.44 with no interest. The first payment was due June, 1987.

Lottery Consultant. On November 30, 1986, the Montana Department of Commerce contracted with Lottery Science, Inc. for lottery consultant services. These services included organization structure, facility specifications, timetables, game implementation plans, and other recommendations. These services

were required due to the July 1, 1987 mandate for an operational lottery.

The contract, covering the period from November 30, 1986 to February 28, 1987, provided for payment of $58.14 per hour not to exceed $30,000, $100 per diem while in Helena, and travel expense reimbursement.

Lottery Consultant. The Montana Lottery contracted with Gaming Dimensions, Inc. on February 27, 1987 for consultant services. These services included timetable development, fiscal and legislative recommendations, security system design, sales structure, and game implementation plans. These services were obtained due to the unexpected death of the consultant associated with Lottery Science, Inc. The contract terms provide for payment of services at $58.14 per hour, $100 per diem while in Helena, and reimbursement of travel expenses.

This contract was amended on June 1, 1987. The consultant's work was redefined to develop a test of the lottery system software, provide advice on start-up and adequacy of training, and prepare a report on the feasibility of an on-line game and regional lotteries. The amended contract provides for payment of the consultant at $58.14 per hour for a maximum of 160 hours per month, $50 per diem while in Helena, and travel expense reimbursement. The contract expired on December 31, 1987.

OTHER

INFORMATION

MONTANA LOTTERY
SUMMARY OF FINANCIAL DISTRIBUTION
(UNAUDITED)
PERIODS ENDED JUNE 30, 1988

COMMISSIONS - Section 23-5-1016(10), MCA provides retailers a 5% commission on tickets or chances sold. This commission on tickets sold to the retailer gives the retailer $25 per book of 500 tickets. The 5% commission of $204,212 and $1,169,378 for the quarter and twelve months ended June 30, 1988 is based on gross lottery ticket sales of $4,084,227 and $23,387,553, respectively.

OPERATING EXPENSES - The Lottery, according to Section 23-5-1027(2), MCA, is allowed "up to 15% of gross revenue for operating expenses." Gross revenue includes net lottery ticket revenue and license fees. While retailer commissions, by law, are not considered an operating expense, interest expense is considered an operating expense for this purpose. The operating expense percentage for the quarter and twelve months ended June 30, 1988, using the accrual basis of accounting, is as follows:

	Quarter ended June 30, 1988 (Unaudited)	Twelve Months ended June 30, 1988 (Unaudited)
Net lottery ticket revenue	$ 3,655,854	$21,056,564
License and permits	800	5,900
Total Gross Revenue	$ 3,656,654	$21,062,464
Operating expenses	$ 670,553	$ 3,326,139
Interest expense	377	18,022
Total Operating Expense	$ 670,930	$ 3,344,161
Operating expense percentage	18.35%	15.88%

Due to increased or decreased financial activity within a quarter, the operating expense percentage will fluctuate above or below the mandated 15% of gross revenue between quarters.

However, operating expenses, as determined by the state budgeting process, by law, must be 15% or less of gross revenue over a fiscal year's time. The operating expense percentage, using the state budgeting process, is as calculated as follows:

	Twelve months ended June 30, 1988
Net lottery ticket revenue	$21,056,564
License and permits	5,900
	$21,062,464
Operating expenses	3,098,480
Operating expense percentage	14.71%

The above operating expenses of $3,098,480 includes $18,022 in interest expense, $594,541 for ticket purchases, $281,129 for installment purchase payments and $41,976 in capital equipment expense. The ticket purchases, installment purchase payments, and capital equipment expenses were reclassified, using the accrual basis of accounting, to reflect the ticket inventory, the decrease in the installment purchase payable, and capitalization of assets.

Nonbudgeted expenses, netting to $169,455, for amortization, depreciation, personal service expense related to compensated absences, and cost of goods sold are not reflected in the operating expenses of $3,098,480. Also, $87,707 in expenses attributed to the Lottery's start up expenses are not included in the $3,098,480 operating expense total.

For budgetary purposes, $11,480 for audit fees is included in the $3,098,480 operating expense above. This audit expense is not included in the financial statements because these fees relate to services to be provided in fiscal year 1988-1989.

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION TRANSFER - The funds transferred to the State Superintendent of Public Instruction, by law, are not based on a percentage of revenue. The distribution is based on a definition of net revenue. Net revenue is that part of all gross revenue not used for the payment of prizes, commissions, and operating expenses. Net revenue for the quarter and twelve months ended June 30, 1988 is detailed below:

	Quarter ended June 30, 1988 (Unaudited)	Twelve months ended June 30, 1988 (Unaudited)
Income before Operating Transfers	$ 1,161,822	$ 7,071,646
Prior Period Adjustments	69,900	67,809
Net Revenue	$ 1,231,722	$ 7,139,455

The net revenue for the quarter of $1,231,722 differs from the $1,232,477 transfer by $755. The $755 represents a legitimate fiscal

year 1987-1988 expenditure recorded on the state accounting system after calculation of the transfer.

PRIZES - Section 23-5-1027(1a) states "as near as possible to 45% of the money paid for tickets or chances must be paid out as prize money..."

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the quarter ended June 30, 1988, the prize expense of $1,619,690 reflects 44.30% of the net lottery ticket revenue of $3,655,854. For the twelve months ended June 30, 1988, the prize expense of $9,477,279 is 45.01% of the net Lottery revenue of $21,056,564.

When recording the prize expense, a corresponding liability for high-tier and Big Spin prizes is also recorded. The relationship between prize expense, prizes paid and the change within prize liability is illustrated below:

April 1 through June 30, 1988		Percent of Net Lottery Ticket Revenue
Prizes paid	$1,256,590	34.36%
Instabucks	(4,180)	(.11)
Increase (decrease) in prize liability	367,280	10.05
Prize expense	$1,619,690	44.30%

July 1 through June 30, 1988		Percent of Net Lottery Ticket Revenue
Prizes paid	$7,070,268	33.58%
Instabucks	(5,020)	(.02)
Increase (decrease) in prize liability	2,412,031	11.45
Prize expense	$9,477,279	45.01%

The prizes paid percentage in both tables is less than the mandated 45% due to the increase in unclaimed prizes and the yet to be purchased annuities for the Jackpot prizes. If these prizes are unclaimed within six months after game end, the remaining funds become available for prizes in other games.